



July 14, 2009

Commission on the 21st Century Economy
c/o State of California Department of Finance
915 L Street, 8th Floor
Sacramento, California 95814

Dear Chairman Parsky and COTCE Commissioners,

It's not too late to choose the best possible tax program for California. Thomas Edison had many failures before he succeeded in inventing the light bulb. Don't let already invested time be the criterion for your choice.

Certainly you plan to make a proposal that will improve California 's tax climate and that will keep the movable job base that we presently have and, in fact, attract business from within the U.S. and from abroad.

Start with business taxation: DON'T DO IT! That is, don't tax businesses because they don't pay taxes, in the final analysis. They pass those costs on to customers, usually, in the form of higher prices. When you take the tax component out of prices, prices will be lower and more competitive.

No less than an authority on economics than Dr. Milton Friedman has said countless times, "Only people pay taxes." He said it in San Francisco at a hearing before President G.W. Bush's Advisory Panel on Federal Tax Reform. Commissioner Dr. Boskin was there, as was I. Dr. Friedman was affirming that "business" taxes are passed on to people, usually the customers.

THE GOVERNOR'S GOALS:

On or before July 31, 2009, the Commission shall deliver a report to the Governor and to the Legislature with recommendations to change laws to achieve the following goals:

- a. *Establish 21st century tax structure that fits with state's 21st century economy.*
- b. *Stabilize state revenues and reduce volatility;*
- c. *Promote the long-term economic prosperity of the state and its citizens;*
- d. *Improve California's ability to successfully compete with other states and nations for jobs and investments;*
- e. *Reflect principles of sound tax policy including simplicity, competitiveness, efficiency, predictability, stability and ease of compliance and administration;*

f. Ensure that tax structure is fair and equitable.

A California version of the national FairTax legislation, a bill now before Congress (H.R 25 and S.296) will work well to restore business competitiveness and make California a business magnet. It will also make individual taxation fair, transparent, more stable, efficient, and greatly reduce compliance costs. It meets and exceeds each of the above goals. The *non-partisan* FairTax is about good economics and good tax policy.

The CA FairTax is a flat rate sales tax (not income tax) on the consumption or use of all new goods and services at retail with a "prebate" (or rebate in advance) to make the purchase of essentials tax-free. It eliminates all *state* income taxes and sales taxes on businesses and individuals and replaces the lost revenue with a 10% broad based sales tax on the consumption or use of all new goods and services in the State of California. When California leads the way in passage of the FairTax, and the Federal government follows, California will be in an even better competitive position relative to competing nations.

James Hines, an economist from the state of Michigan which enacted a state VAT and recently repealed it, testified to this Commission. In his testimony he stated that it is much harder for the tax base to flee from the state when you tax expenditures (consumption) than it is when you rely heavily on income taxes. Dr. Hines makes an eloquent case for the logic of the FairTax.

<http://www.cotce.ca.gov/meetings/testimony/documents/2-JAMES%20HINES%20-%20PPT%20-%20%20Tax%20Feb%2009.pdf>

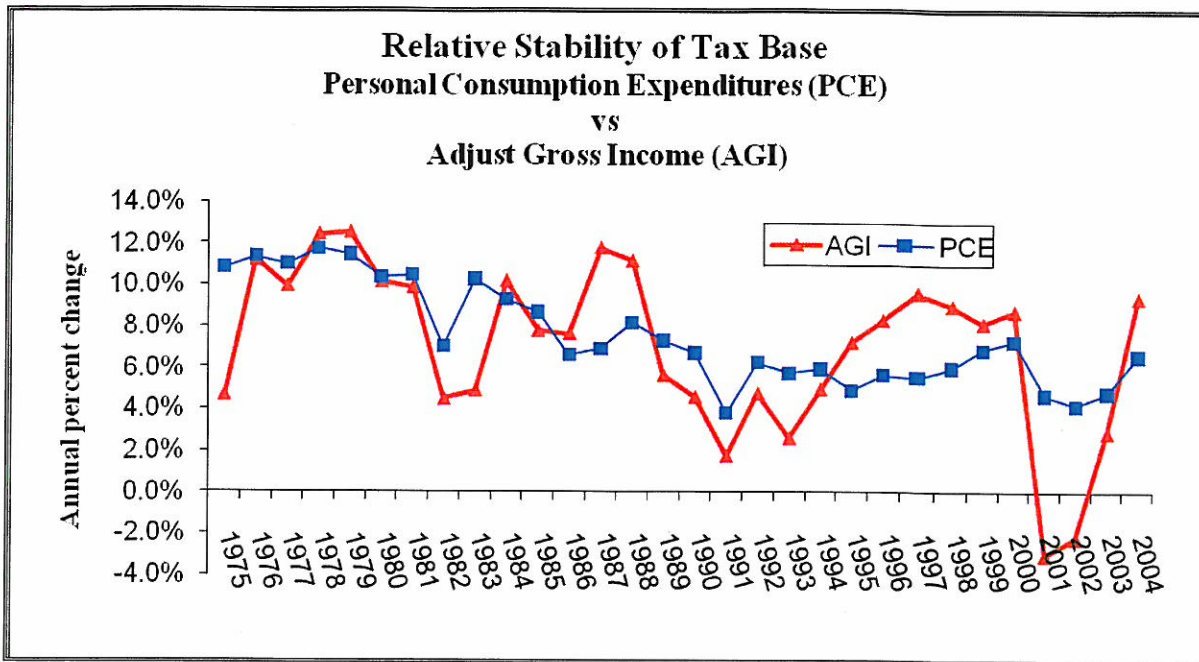
a. "Establish 21st century tax structure that fits with state's 21st century economy."

California, no longer a state merely of agriculture and manufacturing, is a leviathan of Information Technology, entertainment, and other services. In order to create a fair and low rate tax structure, nothing should be excluded from the tax base: both goods and services. For the new century, the tax code must be streamlined, simple, transparent, fair, business friendly, and competitive. A simple low rate consumption tax on all new goods and services, such as the California version of the FairTax, does that.

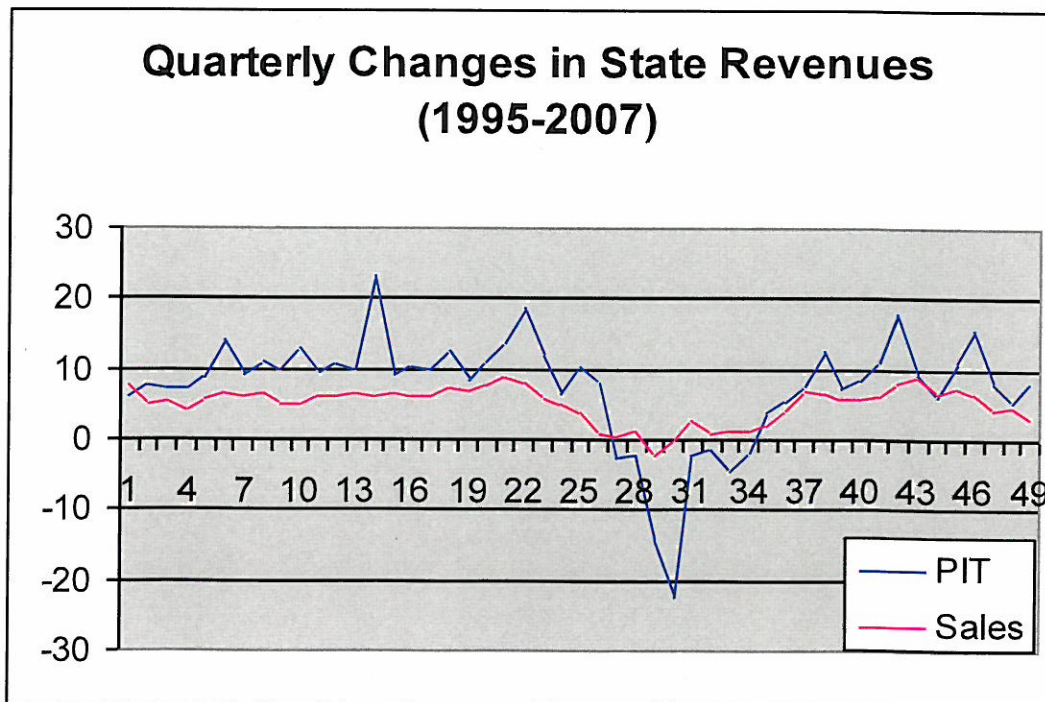
b. "Stabilize state revenues and reduce volatility."

A consumption tax, as opposed to an "income tax" is far more stable. That only makes common sense because, while capital gains and other income may fluctuate wildly, when people experience reductions in income, they don't quit spending; they spend from borrowing and savings.

The graph on the following page compares the gross base of the FairTax with the gross base of the federal income tax. The ups and downs are much greater in income than consumption.



State government revenue data from 1995 to 2007, published by the Rockefeller Institute shows similar results. While the personal income tax revenues (PIT) are spiking regularly, the sales tax line is much more level. What about the giant collapse in the middle of the PIT line? Those are the quarters following September 11, 2001. While American income was dramatically affected, you can see that consumption—while still affected—remained relatively stable.



It is the income tax base that isn't stable and can't be trusted. The consumption base is much more stable and predictable. http://www.rockinst.org/government_finance/state_revenue_reports.aspx

c. "Promote the long-term economic prosperity of the state and its citizens."

Look to the Governor's second "Whereas": "WHEREAS California 's long-term prosperity requires that employers and entrepreneurs INVEST ..."

The CA FairTax taxes only consumption, not savings & investment. When we tax investment, we are not only DIScouraging present investors, but chasing away new investors that can go to Nevada or other nearby states, if not nations, and they will, sooner or later, and often sooner.

The main point under this "goal" is to promote the long-term prosperity of the state and it's citizens. That is precisely what NOT taxing investment will do. The CA FairTax also would not tax consumption for business purposes making California's goods and services competitive compared to other states. Testimony to your Commission provided research that shows that 45.1% of sales tax collections come from taxes paid by businesses.¹

California will become a magnet for U.S. investment, and when California leads the nation in this effort to establish a national sales tax, including a prebate, and eliminating the income tax completely, the USA will make California an even greater magnet for investment and long term prosperity.

Such investment will create jobs and opportunity for our citizens and tax revenues for all necessary state and local services.

A zero business tax rate would make more sense. In fact, having conducted substantial research in this area, The Tax Foundation has concluded that "Contrary to popular misconception, the ultimate burden of corporate income taxes doesn't fall on corporations, but is instead borne by workers, shareholders and consumers." <http://www.taxfoundation.org/research/topic/91.html>

d. "Improve California's ability to successfully compete with other state and nations for jobs and investments";

By not taxing business income, nor business to business (B2B) transactions, California will very successfully compete with other states and nations for investment, and thereby for jobs, particularly with a low flat rate sales tax, with a prebate to untax the poorest and make the rates progressive due to the effect of the prebate. With no "embedded" tax costs in California prices, we will be highly competitive. A flat (income) tax will not achieve this.

A critical key to a successful California economy is INVESTMENT and how it's treated by the tax system. Investment means jobs and tax revenue resulting from the jobs.

Governor Schwarzenegger had it right in this "Whereas" and hit a home run in his goals for this Commission: (the goals are strikingly consistent with the features of the FairTax).

"WHEREAS California 's long-term prosperity requires that employers and entrepreneurs INVEST, remain and grow in the state and that workers desire to live in the state."

Investment will go where it's best treated, not where it's punished. Taxing capital gains, and other investment income, results in diminishing the capital remaining to be invested and thus diminishing job creation. Furthermore, taxing capital results in capital flight to wherever it achieves a better return. It's far better, more fair, and conducive to attracting capital to tax consumption, not investment or income.

e. "Reflect principles of sound tax policy including simplicity, competitiveness, efficiency, predictability, stability and ease of compliance and administration."

The only tax more simple than a flat rate sales tax on the consumption or use of new goods and services is no tax at all. As explained above, the California FairTax will make this state the most competitive. We are not re-inventing the wheel here, only making the wheel better; Texas and Florida already have no income taxes and rely predominantly on sales taxes (however these taxes are not true consumption taxes because they tax B2B transactions). While Nevada is 3rd, Florida is 5th, Texas 7th, and Oregon 9th in the 2009 Tax Foundation study on state tax systems, California is 48th! However, that said, we can best them all by eliminating all taxes on businesses.

<http://www.taxfoundation.org/files/bp58.pdf>

No tax system is more efficient than this proposal. The number of tax filers would be reduced by 80% as individuals will no longer have to file returns. Business sales tax returns are far simpler and much less costly to comply with than corporate income taxes, requiring only the reporting of sales and taxes collected. Sales tax audits are also simpler and less costly to businesses.

As explained above, a broad based consumption tax is a more stable and predictable source of revenue than current state sales taxes (which have very narrow bases) and state income taxes.

The ease of compliance and administration is vastly simplified; tax authorities have merely to verify business sales, and taxes remitted. The present income tax personnel can be utilized to ascertain the bona fides of applicants for the prebate as to their legitimate claim of residence.

f. "Insure that the tax structure is fair and equitable."

Contrary to the conventional wisdom, a sales tax based on consumption can be progressive. The CA FairTax is progressive by the addition of a monthly prebate based on the amount of tax that would be paid on spending up to the poverty level. The prebate essentially makes spending on the basics of living tax-free. The chart below shows the annual amount of tax free spending and the monthly prebate based on a CA FairTax rate of 10%.

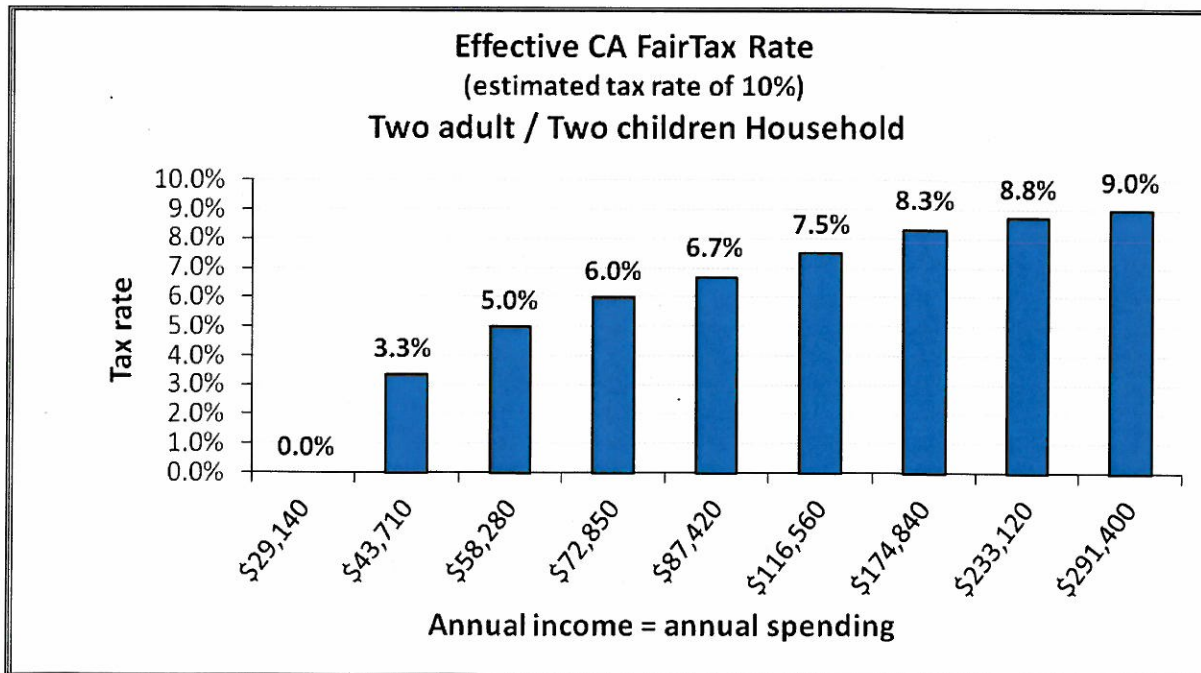
The prebate completely untaxes the truly poor and lowers the effective tax rate of lower and middle-income California residents. There is no need for any exemptions for food, shelter, medical expenses, etc. as the prebate is received by all legal California households to pay the tax on the necessities of life. Above that point everyone pays at the same rate. The prebate would be placed electronically into the bank account of the head of household (or mailed) and the amount would be determined solely by the number of legal residents living in the household with valid Social Security numbers.

**2009 Prebate Calculation for CA FairTax
(estimated revenue neutral rate of 10%)**

One adult household				Two adult household			
Family Size	Annual Consumption Allowance	Annual Prebate	Monthly Prebate	Family Size	Annual Consumption Allowance ¹	Annual Prebate	Monthly Prebate
1 person	\$10,830	\$1,083	\$90	couple	\$21,660	\$2,166	\$181
and 1 child	\$14,570	\$1,457	\$121	and 1 child	\$25,400	\$2,540	\$212
and 2 children	\$18,310	\$1,831	\$153	and 2 children	\$29,140	\$2,914	\$243
and 3 children	\$22,050	\$2,205	\$184	and 3 children	\$32,880	\$3,288	\$274
and 4 children	\$25,790	\$2,579	\$215	and 4 children	\$36,620	\$3,662	\$305
and 5 children	\$29,530	\$2,953	\$246	and 5 children	\$40,360	\$4,036	\$336
and 6 children	\$32,270	\$3,227	\$269	and 6 children	\$44,100	\$4,410	\$368
and 7 children	\$37,010	\$3,701	\$308	and 7 children	\$47,840	\$4,784	\$399

Prepared by Karen Walby, Ph.D., Director of Research, www.fairtax.org. Poverty guidelines from the Federal Register, Vol. 74 No. 14, January 23, 2009, pp. 4199-4201, and tax rate estimates based on Beacon Hill Institute Study, Fiscal Federalism: the National FairTax and the States, Sept. 2007.

The chart below shows how the prebate affects the effective tax rate and creates a progressive tax rate structure.



While everyone pays the same tax rate at the cash register, the prebate results in an effective tax rate (annual taxes paid divided by annual spending) that increases as the level of spending increases, resulting in a progressive tax rate structure. For those at the poverty level the tax rate is zero percent.

For those at four times the poverty level the effective tax rate is 7.5% (based on an estimated revenue neutral rate of 10%.)

The charts above indicate that the California FairTax will be fair equitable and progressive. The fact that investment is not taxed is a bonus for all in that it will leave more dollars for job building enterprises and, when and if consumed, it will be taxed.

The CA FairTax is fair and equitable and will be even more so when the federal government follows our lead and enacts a national FairTax which will eliminate all federal income taxes including the highly regressive payroll tax.

To quote a letter to the President signed by over eighty economists: "The economic benefits of the FairTax Plan are compelling. The FairTax Plan eliminates the tax bias against work, saving, and investment, which would lead to higher rates of economic growth, faster growth in productivity, more jobs, lower interest rates, and a higher standard of living for the American people.

http://www.fairtax.org/PDF/Open_Letter.pdf

The California FairTax is vastly superior to any other proposals. More than \$22M dollars were expended in academic and market research, starting with a blank sheet of paper and no preconceived notions.

http://www.fairtax.org/site/PageServer?pagename=about_research

The only thing that prevents this logical, efficient, fair, and competitive tax system from implementation is special interests. The California economy and its citizens must not be held captive any longer by those interests.

Yes, many untruths have been told about this plan because we are goring many oxen in the general interest.

Respectfully,

William D. Spillane
California State Director (volunteer)
Americans For Fair Taxation
www.FairTax.org

A handwritten signature in cursive script, appearing to read "Leo Linbeck, Jr.", followed by a long horizontal line that ends in a small arrowhead pointing to the right.

Leo Linbeck, Jr.
Chairman and CEO (volunteer)
Americans For Fair Taxation
www.FairTax.org